

## Internal Revenue Service

Number: **200819003**

Release Date: 5/9/2008

Index Number: 7702.20-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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, ID No.

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CC:FIP:B04

PLR-104383-07

Date:

December 27, 2007

### LEGEND:

Taxpayer =

Date 1 =

Date 2 =

Number C =

Number F =

Number G =

Number H =

Number I =

Number J =

Dear

This is in response to your request of Date 1, as supplemented, for a ruling granting a waiver under § 7702(f)(8) of the Internal Revenue Code for Number H flexible premium universal life insurance policies (the “Contracts”) issued by Taxpayer that failed to meet the requirements of § 7702(a). The Contracts are listed in Exhibit A. You request that the Contracts be treated as life insurance contracts for federal income tax purposes.

## FACTS

The information submitted indicates that Taxpayer is a stock life insurance company subject to Taxation under Part I of Subchapter L of the Code. Taxpayer is licensed under the laws of Number C states. Taxpayer has not actively sold life insurance since Date 2, however it has approximately Number F policies currently in force, of which Number G are universal life policies.

Taxpayer intended that each of its life insurance policies meet the definition of a life insurance contract under § 7702 by satisfying the guideline premium limitation of section 7702(c). During the late 1980s and early 1990s, employees of Taxpayer performed the tests required under the guideline premiums requirements of § 7702(c) using hand calculations. In evaluating its compliance with Rev. Rul. 2005-6, 2005-1 C. B. 471, concerning the use of the expense charge rule for purposes of determining compliance of policies with qualified additional benefits (QABs) with the guideline premium requirements, Taxpayer discovered errors which resulted in the failure of Number H Contracts all of which were issued after 1985.

Taxpayer administered these Contracts using a manual administrative system prior to the implementation of the current automated administration system. Under Taxpayer’s prior manual administrative system mathematical errors caused Number I contracts to fail §7702. All policies that were issued were recalculated using a detailed spreadsheet that had been thoroughly checked for accuracy. In converting to the current automated administration system, the same manual process was employed with an additional recheck of all the values. Once the values were confirmed to be correct, the values were automatically uploaded onto a new automated administration system. In the case of Number J Contracts, the Taxpayer manually accounted for policy adjustments, and mathematical errors occurred in the §7702 calculation. In the case of Number J Contracts, the system properly accounted for face amount reductions but personnel failed to follow through and refund money forced out of the Contracts. Taxpayer has periodically updated and refined the automated administrative system to further improve compliance with §7702 since the system’s implementation. The system

users have received and continue to receive periodic training in the use of the system so as to ensure compliance. Taxpayer will also bring the contracts into compliance by making refunds of premium (including interest on the premium amount calculated at the contract rate) to each contract holder.

## LAW & ANALYSIS

In general, for contracts issued after December 31, 1984, § 7702 provides a definition of the term “life insurance contract” for all purposes of the Code. To satisfy this definition, a life insurance or endowment contract must be treated as such under the applicable law. The life insurance contract must also satisfy either the cash value accumulation test of § 7702(a)(1) and § 7702(b), or both the “guideline premiums requirements” of § 7702(a)(2)(A) and § 7702(c) and fall within the “cash value corridor test” of § 7702(a)(2)(B) and § 7702(d).

With respect to the guideline premium requirements, § 7702(c) requires that the premium paid under the contract at any time must not exceed the greater of the guideline single premium or the sum of the guideline level premiums to that date. The guideline single premium is the single premium at issue that is needed to fund the “future benefits” under the contract determined on the basis of the following three elements enumerated in § 7702(c)(3)(B)(i)-(iii);

- (i) reasonable mortality charges which meet the requirements (if any) prescribed in regulations and which (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners’ standard tables (as defined in §807(d)(5)) as of the time the contract is issued,
- (ii) any reasonable charges (other than mortality charges) which (on the basis of the company’s experience, if any, with respect to similar contracts) are reasonably expected to be actually paid, and
- (iii) interest at the greater of an annual effective rate of 6 percent or the rate or rates guaranteed on issuance of the contract.

The guideline level premium means the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium, except § 7702(C)(3)(B)(iii) shall be applied by substituting “4 percent” for “6 percent.” Accordingly, the amount of both the guideline single premium and guideline level premium is proportional to the amount of future benefits under the contract. The computational rules of § 7702(e) and the definitions of § 7702(f) apply to both the guideline single premium and the guideline level premium.

Section 7702(f)(1)(B) generally provides that, if the premiums paid exceed the guideline premium limitation, and the issuer refunds the excess (with interest) within 60 days after the end of the policy year, then the amount returned (without interest) is deemed to reduce the sum of the premium paid under the contract during the year.

Pursuant to 7702(f)(8), the Secretary of the Treasury may waive a failure to satisfy the requirements of § 7702. This waiver is granted if a taxpayer establishes that the statutory requirements were not satisfied because of reasonable error and that reasonable steps are being taken to remedy the error.

Under the facts as submitted, the failure of Number H Contracts to satisfy the requirements of §7702(a) was caused by reasonable error. Taxpayer has instituted procedures to reduce or eliminate the likelihood that such errors will recur. Taxpayer also has taken reasonable steps to remedy the failure of the Contracts to satisfy the requirements of § 7702(a).

Accordingly, based on the information submitted, the failure of Number H Contracts (set forth in Exhibit A) to satisfy the requirements of §7702(a) is waived pursuant to §7702(f)(8). However, any contracts that are not cured within 90 days of the date of this letter are not covered by this waiver.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Associate Chief Counsel  
(Financial Institutions and Products)

By: Donald J. Drees, Jr.  
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Branch 4